United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLANT

Signed

74-1036

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

CITY TRUST COMPANY, Executor
of the Will of Frederick A.
Lockwood, Deceased,

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES

DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLANT

SCOTT P. CRAMPTON,
Assistant Attorney General,

MEYER ROTHWACKS,
GARRY R. ALLEN,
DONALD H. OLSON,
Attorneys,
Tax Division,
Department of Justice
Washington, D. C. 20530

Of Counsel:

STEWART JONES,
United States Attorney.

TABLE OF CONTENTS

Page

Statement of the issue presented---------- 1
Statement of the case---------- 2
Summary of argument---------- 4
Argument:

The trustee's power to invade corpus to provide for the "happiness" of decedent's wife during her life, and its power to pay amounts to her "for whatever she may desire" clearly render the value of the charitable remainder interests nonascertainable and, thus, no estate tax deduction is allowable with respect thereto---------- 7

A. The applicable principles of federal estate tax law---------- 7

B. The applicability and impact of Connecticut law---------- 13

C. The Magistrate's opinion is in error both in its construction of decedent's will and in its analysis of applicable law---------- 17

Conclusion---------- 27
Appendix---------- 29

CITATIONS

Cases:

Connecticut Bank & Trust Co. v. Lyman, 148 Conn. 273, 170 A. 2d 130 (1961)--------- 14,15,16,17
Ford, Estate of v. Commissioner, 53 T.C. 114 (1969), aff'd per curiam, 450 F. 2d 878 (C.A. 2, 1971)---------- 24,25,26,27
Gammons v. Hassett, 121 F. 2d 229, (C.A. 1, 1941), cert. denied, 314 U.S. 673 (1941)---- 22
Hartford National Bank & Trust Co. v. United States, 467 F. 2d 782 (C.A. 2, 1972)--------- 7,11,26
Henslee v. Union Planters Bank, 335 U.S. 595 (1949)---------- 10,12
Hooker v. Goodwin, 91 Conn. 463, 99 Atl. 1059 (1917)---------- 23
Ithaca Trust Co. v. United States, 279 U.S. 151 (1929)---------- 8,9

Page

Cases (continued):

Lincoln Rochester Tr. Co. v. Commissioner, 181 F. 2d 424 (C.A. 2, 1950)---------- 11
Marine Trust Co. of Western New York v. United States, 247 F. Supp. 278 (W.D. N.Y., 1965)---------- 22
Merchants Bank v. Commissioner, 320 U.S. 256 (1943)---------- 8,10,12,19
Rand v. United States, 445 F. 2d 1166 (C.A. 2, 1971)---------- 19
Salisbury v. United States, 377 F. 2d 700 (C.A. 2, 1967)---------- 11,24
State Street Bank and Trust Co. v. United States, 313 F. 2d 29 (C.A. 1, 1963)---------- 21,22
Union Trust Co. v. Tomlinson, 355 F. 2d 40 (C.A. 5, 1966)---------- 21
United States v. Commercial National Bank of Kansas City, 404 F. 2d 927 (C.A. 10, 1968)---------- 13,26
United States v. Powell, 307 F. 2d 821 (C.A. 10, 1962)---------- 24,25,26,27

Statutes:

Internal Revenue Code of 1954 (26 U.S.C.):
Sec. 2036---------- 24,25
Sec. 2038---------- 24,25
Sec. 2055---------- 7,29
Moser, Charitable Gifts to Foundations, 13 N.Y.U. Institute on Federal Taxation, 223, 226-227 (1955)---------- 13
Treasury Regulations on Estate Tax, § 20.2055-2 (26 C.F.R.)---------- 7,29

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 74-1036

CITY TRUST COMPANY, Executor
of the Will of Frederick A.
Lockwood, Deceased,

Plaintiff-Appellee

v.

UNITED STATES OF AMERICA,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES

DISTRICT COURT FOR THE DISTRICT OF CONNECTICUT

BRIEF FOR THE APPELLANT

STATEMENT OF THE ISSUE PRESENTED

Whether, on the facts of this case, the trustee's discretionary power to invade corpus for the benefit of the non-charitable life beneficiary was so broad as to prevent the value of the charitable remainder interest from being "presently ascertainable" and, therefore, to preclude decedent's estate from being entitled to an estate tax deduction with respect to that remainder interest under Section 2055 of the Internal Revenue Code of 1954 and the applicable Regulations.

STATEMENT OF THE CASE

This appeal involves the taxpayer-estate's suit for refund of federal estate taxes. Following a timely administrative claim for refund, this action was commenced in the District Court. (R. 20.)[1/] The case was tried upon fully stipulated facts and the court filed its memorandum of decision on cross-motions for summary judgment on May 3, 1973. (R. 22-30.)[2/] Judgment was entered on July 30, 1973, awarding taxpayer $197,497.53 plus interest. (R. 31.) The Government filed its notice of appeal on September 24, 1973. (R. 32.) This Court's jurisdiction rests upon 28 U.S.C., Section 1291.

The pertinent facts may be summarized as follows:

The decedent, a resident of Connecticut, died testate on May 21, 1966 (R. 19), and Article 3 of his will (R. 11-17) provides, in relevant part (R. 11-12):

> All of the rest, residue and remainder of my property, real and personal, of whatsoever the same may consist and wheresoever it may be situated, I give, devise and bequeath to my trustee hereinafter named, UPON TRUST, HOWEVER, for the following uses and purposes: to hold, manage, sell, invest and reinvest the same and to pay the net income therefrom to or for the

1/ "R." references are to the separately-bound record appendix.

2/ The memorandum of decision was prepared and signed by a United States Magistrate and was endorsed by District Judge Newman. Since the entry of the opinion and judgment herein in April and July, 1973, respectively, the Acting Attorney General, on December 4, 1973, issued Order No. 557-73 published in the Federal Register on December 12, 1973 (38 Fed. Reg. 34203), pointing out that, under applicable Supreme Court and other federal decisions, the use of magistrates as special masters to render decisions in dispositive matters is inappropriate and should be challenged by the respective legal Divisions of the Department

> benefit of my dear wife, ALICE DREW LOCKWOOD, during her life. My trustee may, in its absolute and unhampered discretion, pay so much of the principal of this trust as it may deem to be necessary for the proper care, comfort, welfare and happiness of my wife. It is my desire that my wife may occupy her own home and live in the manner to which she has been accustomed in our life together so long as she desires to do so, and that she shall have from my estate at least Five Hundred Dollars ($500.00) a month from the date of my death, with payments to begin as soon after my death as is practicable, for her own personal spending money and for whatever she may desire, after the payment of all of her necessary expenses. I direct my executor and trustee to begin to make regular monthly payments to my wife on account of the income which is due or will become due to her as soon after my death as it is practicable to do so.

Article 3 further provides that at the death of the wife, the "net income of the trust" shall be paid to dececent's sister and others for the sister's life. Upon the death of the survivor of decedent's wife and his sister, the trust is to cease, and one-half of the remaining trust assets is to be paid to named charities and the other half is to go to noncharitable beneficiaries. (R. 12-14.)

2/ (continued)

of Justice through application for a writ of mandamus or otherwise. Inasmuch as the reference to the Magistrate herein and the entry of judgment preceded this order, no objection has been asserted here. However, the Government does intend to challenge the use of Magistrates as special masters in dispositive matters in Connecticut and elsewhere, and, indeed, an interlocutory appeal involving this issue is presently pending in the Ninth Circuit (Weber v. Weinberger, No. 73-3593, order allowing interlocutory appeal entered December 21, 1973).

Taxpayer claimed an estate tax deduction for the alleged value of the charities' one-half remainder interest in decedent's testamentary trust. The Internal Revenue Service disallowed that deduction on the grounds that the trustee's broad power to invade corpus for the wife's benefit during her life prevented the value of the charitable remainder from being "presently ascertainable" as is required by applicable law. The District Court held that taxpayer was entitled to the disputed deduction, and this appeal followed. (R. 5, 8, 19-20, 23-24, 29-30.)

SUMMARY OF ARGUMENT

A testamentary gift of a remainder interest to charitable beneficiaries is deductible for federal estate tax purposes only if the value of that remainder interest is "presently ascertainable." It is well established by decisions of the Supreme Court, as well as by this Court, that a trustee's power to invade corpus for the benefit of the life tenant will render a charitable remainder nondeductible unless that power is restricted by a definitely calculable standard, such as, for the maintenance of the life tenant's accustomed standard of living. Trust powers which go beyond that, e.g., to invade for the "happiness" of the life tenant, or to satisfy his or her "desires," will disqualify an otherwise allowable charitable remainder deduction.

In this case the decedent directed the trustee to invade corpus for his wife's "necessary expenses" and expressed his desire that she "may * * * live in the manner to which she has been accustomed in our life together so long as she desires to do

so." In addition, the trust provides that corpus (potentially destined for charity) may be further invaded for the "happiness" of decedent's wife and that she should receive "at least" $500 per month "for whatever she may desire."

The decision below is based upon the Magistrate's reasoning that all of the above language, though "ill-matched," is merely an expression of decedent's intent that his wife maintain her accustomed standard of living and that the value of the charitable remainder, therefore, is presently ascertainable (and, hence, deductible). But the Magistrate overlooked the oft-recognized principle in this context that a settlor may provide fixed, minimum standards for his beneficiaries' maintenance and, at the same time, may fix wider, discretionary standards for invasion of corpus beyond the narrow minimum standard. Here the decedent directed the trustee to pay the wife's "necessary expenses" (which, under applicable Connecticut law, include those needed to maintain her former standard of living), plus $500 per month. The potential impact upon corpus of that invasion standard, alone, is readily calculable and, under applicable law, does not preclude the allowability of a deduction for the charitable remainder. But, of critical significance here, decedent went further. He gave the trustee discretion, without apparent limit, to invade corpus for the wife's "happiness" and for "whatever she may desire." Connecticut law permits unlimited invasion of corpus under such broad grants of discretion.

In the final analysis, the inquiry here really is directed at ascertaining whether the decedent intended that preservation of corpus for the charity be the overriding consideration in his trustee's mind or whether his wife's "happiness" and "desires" were to be given principal consideration. Here the language used by decedent reflects a clear preference for his wife. Indeed, the trustee's broad discretion begins with amounts to be paid by it to the wife above and beyond her "necessary expenses," plus $500 per month. There is no upper limit placed upon the amounts which can be paid, in the "absolute and unhampered discretion" of the trustee, for the wife's "happiness."

The extent to which corpus might be invaded for the wife's lifetime benefit, therefore, is not "presently ascertainable," and the charitable remainder deduction here in issue is not allowable.

ARGUMENT

THE TRUSTEE'S POWER TO INVADE CORPUS TO PROVIDE FOR THE "HAPPINESS" OF DECEDENT'S WIFE DURING HER LIFE, AND ITS POWER TO PAY AMOUNTS TO HER "FOR WHATEVER SHE MAY DESIRE" CLEARLY RENDER THE VALUE OF THE CHARITABLE REMAINDER INTERESTS NONASCERTAINABLE AND, THUS, NO ESTATE TAX DEDUCTION IS ALLOWABLE WITH RESPECT THERETO

A. The applicable principles of federal estate tax law

Section 2055(a) of the Internal Revenue Code of 1954 (Appendix, infra) allows a deduction from the gross estate for the value of certain charitable bequests made by a decedent. Under long-standing Regulations, the deduction is allowable for charitable remainder interests only if the value thereof is "presently ascertainable." See Treasury Regulations on Estate Tax (1954 Code), § 20.2055-2(a) (Appendix, infra). Thus, if any part of a charitable remainder interest is subject to being diverted by the exercise of a trust power, the deduction is limited to the portion of the trust corpus which is exempt from the exercise of that power. Regulations § 20.2055-2(b) (Appendix, infra).[3/]

3/ As discussed at footnote 7 of this Court's decision in Hartford National Bank & Trust Co. v. United States, 467 F. 2d 782, 784 (1972), the law governing the deductibility of charitable remainder interests was changed by the Tax Reform Act of 1969. Congress more narrowly circumscribed the conditions under which such deductions will be allowed after the effective dates of that amendment. This case, however, is governed by the law as it existed prior to 1969.

These regulatory provisions have been accepted by the courts as valid interpretations of the statute, and there is an abundance of precedent to refer to for guidance in applying them here. In Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), the trustee was empowered to invade corpus for the benefit of the decedent's wife to the extent "that may be necessary to suitably maintain here in as much comfort as she now enjoys." In sustaining the deductibility of the charitable remainder in issue there, the Court said (p. 154):

> The principal that could be used was only so much as might be necessary to continue the comfort then enjoyed. The standard was fixed in fact and capable of being stated in definite terms of money. It was not left to the widow's discretion.

Subsequently, in Merchants Bank v. Commissioner, 320 U.S. 256, 257-258 (1943), the Court undertook a more comprehensive analysis of the estate tax consequences of a transfer of property where enjoyment thereof is split between charitable and noncharitable beneficiaries. There the decedent had created a charitable remainder interest following a life estate in his wife, and the trustee was authorized to invade corpus during the wife's lifetime "at such time or times as my said Trustee shall in its sole discretion deem wise and proper for the comfort, support, maintenance and/or happiness of my said wife, and it is my wish and will that in the exercise of its discretion with reference to such payments from the principal of the trust fund to my said wife, May L. Field, my said Trustee shall exercise its discretion with liberality to my said wife, and consider her

welfare, comfort and happiness prior to claims of residuary beneficiaries under this trust."

Looking to the applicable Regulations, the Court stated (p. 260):

> * * * where a trust is created for both charitable and private purposes the charitable bequest, to be deductible, must have, at the testator's death, a value "presently ascertainable, and hence severable from the interest in favor of the private use," and further, to the extent that there is a power in a private donee or trustee to divert the property from the charity, "deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power." These Regulations are appropriate implementations of [the statute] * * *, and, having been in effect under successive reenactments of that provision, define the framework of the inquiry in cases of this sort.

Applying those rules to the case before it, the Court found to be irrelevant the fact that the life beneficiary had substantial independent means and was of an advanced age. "The salient fact is that the purposes for which the widow could, and might wish to have the funds spent do not lend themselves to reliable prediction" as was required by Ithaca Trust Co., supra. (320 U.S., p. 262.) "Introducing the element of the widow's happiness and instructing the trustee to exercise its discretion with liberality to make her wishes prior to the claims of residuary [charitable] beneficiaries brought into the calculation elements of speculation too large to be overcome, notwithstanding the widow's previous mode of life was modest and her own resources substantial." (Id., p. 263.)

Thereafter, the apparent breadth of the holding in Merchants Bank was put to test in Henslee v. Union Planters Bank, 335 U.S. 595 (1949). There the decedent's will provided for $9,000 per year to be paid to his 85-year-old-mother for her life "to be used by her as she sees fit," and, in addition to that amount, the trustees were authorized, in their discretion, to use "any portion of my estate either income or principal, for the pleasure, comfort and welfare of my mother." (Id., p. 596.) The trustees were directed that their first object was "to take care of and provide for my mother in such manner as she may desire." (Ibid.) A portion of the estate was bequeathed to charities upon the mother's death. The charitable remainder was held not to be deductible from decedent's gross estate, even though trust income of $15,000 per year was available to satisfy the $9,000 annual payment to decedent's mother due from the trust. The evidence indicated that the mother lived on substantially less than $9,000 per year, she had $100,000 of her own income-producing wealth, and she died three years after decedent without having sought or received any corpus. The Court held that the "pleasure, comfort and welfare" language describing the trustees' scope of discretion to invade corpus during the mother's life precluded a triable issue of fact as to whether the value of the charitable remainder was presently ascertainable. The unlikelihood of invasion was held to be irrelevant, because "It is apparent on the face of the complaint that this testator's will did not limit the trustees' disbursements to conformity with some ready

standard--as where, for example, trustees are to provide the prime beneficiary with such sums as 'may be necessary to suitably maintain her in as much comfort as she now enjoys.' Ithaca Trust Co. * * *." (Id., p. 598.)

Subsequent decisions of this Court are in accord. In Lincoln Rochester Tr. Co. v. Commissioner, 181 F. 2d 424 (1950), after analysis of the foregoing Supreme Court decisions, the Court held that invasion of principal "as may be necessary for * * * [the life tenant's] proper care, support and maintenance" did not prevent the charitable remainder from being presently ascertainable. But in so holding, the Court noted (p. 425) that "a mandate to the trustee to 'be liberal' or to concern itself with the beneficiary's 'happiness' or 'pleasure'" would require a contrary result. Similarly, see Salisbury v. United States, 377 F. 2d 700, 704-705 (1967), where this Court saw the question as being whether the words used there ("care, support and benefit") were equivalent to the objective standard of the beneficiary's "station in life."

More recently, this Court reiterated the standards to be applied here in Hartford National Bank & Trust Co. v. United States, 467 F. 2d 782, 783 (1972). Corpus was available there, as necessary, to provide for the "physical welfare" of the life beneficiaries. And while the Court appeared to accept the District Court's conclusion that "welfare," alone, is too vague a standard to support a deduction for the charitable remainder interest, it, nonetheless, reversed the District Court's finding

of nondeductibility, because it viewed the word "physical" as being a significant modifier which transformed the invasion standard to the equivalent of maintaining the life tenants' "accustomed standard of living." (Id., p. 786.) In the course of its opinion, however, the Court noted that a contrary result would be required if the invasion standard included "subjective" elements such as the life beneficiaries' "happiness." (Id., pp. 785-786.)

These cases, which adopt the interpretation of the statute stated in the Regulations, and which further explicate the proper standards to be applied, are, in our view, dispositive here. They require an unequivocal, objective limitation on the trustee's power to divert corpus, otherwise potentially destined to charity, for noncharitable purposes. The trustee here was admonished to use principal as it saw fit to provide not only for the life tenant's "proper care, comfort [and] welfare" but also for her "happiness," and, further, the trustee was expressly authorized to invade corpus to provide unlimited amounts "for her own personal spending money and for whatever she may desire" on top of her necessary expenses. (R. 12.)

There is no apparent basis, therefore, upon which this case can be distinguished from Merchants Bank and Union Planters Bank, supra. Indeed, it seems a fair summary of the Supreme Court teachings to say that whenever a trustee's power of invasion goes beyond providing for a life tenant's necessary living expenses (based upon his or her prior lifestyle), no deduction is allowable for any charitable remainder interest. And having executed his will in 1962 (R. 17), many years after

these decisions, decedent can be expected to have known the natural consequences which would follow from the broad invasion powers which he granted his trustee. See Moser, Charitable Gifts to Foundations, 13 N.Y.U. Institute on Federal Taxation, 223, 226-227 (1955). Cf. United States v. Commercial National Bank of Kansas City, 404 F. 2d 927, 934 (C.A. 10, 1968).

B. The applicability and impact of Connecticut law

In further analyzing the trustee's invasion powers here, we must look to local (Connecticut) law to determine whether the property consequences which follow from the specific grant of discretion which is in issue might differ from those consequences in other jurisdictions. Article 3 of decedent's will, supra, provides that the trustee may invade corpus (R. 11):

1. "[A]s it may deem to be necessary ["in its absolute and unhampered discretion"] for the proper care, comfort, welfare and happiness of my wife."

2. To provide "at least * * * ($500.00) a month * * * for her own personal spending money and for whatever she may desire, after the payment of all of her necessary expenses."

The inquiry in cases such as this necessarily involves analysis of other federal tax cases, but, of course, the threshold question is how the Connecticut courts would construe these provisions - i.e., what actually would happen if the wife, or the trustee, petitioned the Connecticut courts for instructions as to whether she might receive, for example, $5,000 per month to travel extensively with her wealthy acquaintances or

perhaps she might seek greater monthly amounts or even ask for occasional large lump-sum payments to provide the material pleasures which "she may desire" for her "happiness" in her unaccustomed role as a widow. (Cf. R. 28.)

Although we are unable to point to any Connecticut case which involved such circumstances in the context of identical trust provisions, we think that the relatively recent decision in Connecticut Bank & Trust Co. v. Lyman, 148 Conn. 273, 170 A. 2d 130 (1961), while distinguishable in many respects, provides solid support for our view that the trustee's discretionary satisfaction of such desires of the wife would be honored in Connecticut under the trust provisions involved here. (Cf. R. 28.) In that case the trust provided that decedent's second wife would receive the income from one-half of the trust corpus for life and that she should receive principal payments from that portion of the trust "either on the judgment of the Trustee as to their being needed because of her illness or absence or other emergency, or at the written request of said [wife] or for both of said reasons." (148 Conn., p. 276, 170 A. 2d, p. 132.) On the wife's death the remainder was payable to the settlor's issue (who were children and their descendants of decedent's first marriage) and upon default of issue, to certain charities.

The decedent died in 1959, and five weeks later the second wife requested and received a principal payment of $25,000. Five months later, she requested that the entire principal balance be paid to her forthwith. At that time the principal balance appears to have been roughly $900,000, and the wife's current income therefrom, $20,000. In addition, she received $5,000 per year from her own assets. She made no claim that she had any need for the principal balance.

Upon the trustee's suit for construction of the trust, and over the objection of decedent's issue, the court held that the wife was entitled to the principal balance as a matter of right. The court acknowledged (148 Conn., p. 278, 170 A. 2d, p. 132) that the effect of its decision was "to terminate this portion of the trust and destroy any possibility that from it the settlor's issue, or the contingent charitable beneficiaries, will receive anything."

In the instant case decedent provided first that principal should be paid to the wife in amounts which the trustee in its discretion "may deem * * * necessary for the * * * happiness of my wife." As to that grant of power, we agree that, unlike the trust involved in the Lyman case, the wife could not demand large amounts of principal as a matter of right, but we believe that distinction to be irrelevant here. Our question would present to the Connecticut court the issue whether the trustee could be prevented from exercising its discretion in making large principal payments. We think that Judge King's opinion

in the Lyman case indicates that court's inclination to give effect to the lack of expressed limitation on the trustee's discretion to invade on a vague standard of "happiness."

Furthermore, and perhaps of dispositive significance here, Article 3 of decedent's will goes on to provide (R. 12): "It is my desire that my wife * * * shall have * * * at least * * * ($500.00) a month * * * for her own personal spending money, and for whatever she may desire." We submit that the decedent's additional request that the trustee enable his wife to "occupy her own home and live in a manner to which she has been accustomed," in no way disturbs decedent's plain intention that the trustee not be limited by any particular objective standard in making further discretionary expenditures for her "happiness" and personal "desires." Indeed, as so expressed without limitation, that language might even be construed, in light of Lyman, to give the wife the right to principal payments upon request as a matter of right. But, all that we must establish here is that the invasion power was of sufficient breadth so as to make the present value of the charitable remainder indefinite in amount, and we think that within the broad range of possible interpretations which might be applied to Article 3, it is rather clear (and we have found no Connecticut cases to the contrary) that the Connecticut court would permit substantial discretionary invasions by the trustee for reasons unrelated to the prior standard of living of decedent's wife.

C. The Magistrate's opinion is in error both in its construction of decedent's will and in its analysis of applicable law

The error of the Magistrate's opinion is revealed in the analysis of what he called "an aggregation of at least superficially ill-matched phrases and terms." (R. 25.) We agree that if the decedent did intend to limit the trustee's invasion powers to maintaining his wife's accustomed standard of living (as the Magistrate concluded, R. 28-29), then Article 3, indeed contains "ill-matched phrases and terms." But, rather than regarding them as such, we see this case as involving several standards--some involving attention to the wife's minimum needs and others involving vague limitations upon the trustee's exercise of discretion in making payments for additional purposes.

As the Connecticut court stated in Lyman (148 Conn., p. 279, 170 A. 2d, p. 133), in interpreting language such as this, a court should, as far as possible, put itself in the settlor's position. Here, we can see that decedent most certainly wanted his wife's standard of living maintained, and with the direction to pay "at least" $500 per month to her above and beyond those needs, we can see that he did not want the identity of his wife's living requirements to be a subject of dispute between her and the corporate trustee. Decedent's first goal thus was to take out of the trustee's discretion the payment of his wife's "necessary expenses" with an assured $500 per month cushion.

Secondly, however, decedent appears to have consciously decided not to stop with the provision for her "necessary expenses," plus $500 per month. He directed the trustee to concern itself with, inter alia, his wife's "happiness." Since her "necessary expenses" were more than amply taken care of by express directions to the trustee, the "absolute and unhampered" discretion given the trustee in Article 3 must relate to something more than meeting the objectively measurable cost of maintaining his wife's existing station in life. While decedent apparently did not wish to leave to the trustee's discretion the payment of his wife's normal expenses, he was willing to entrust the trustee with the discretion to make additional payments, and the discretion which decedent gave the trustee to make those extra payments (from corpus if necessary) could not have been broader. Instructed to concern itself with the wife's "happiness," the trustee was told to give her "at least" $500 per month "for her own personal spending money and for whatever she may desire." In short, the decedent fixed a minimum standard of expenditure for his wife's benefit, but fixed no maximum whatsoever on the amount of discretionary expenditures which might further be made in the interests of maintaining her "happiness" and satisfying her "desires."

These provisions thus may seem "ill-matched" to one looking only to the allowability of an estate tax deduction for the charitable remainder interest, but from a property standpoint, the provisions are entirely complementary and

accomplish the decedent's obvious purpose of carefully guarding against the possibility that the trustee in the exercise of its discretion would make inadequate provision for his wife, while at the same time, placing no limitations upon the trustee's discretion to provide for the wife's "happiness" too generously. There simply is no language in the will for the remaindermen to point to if they sought to challenge the trustee's decision to make, e.g., $5000 per month payments to decedent's wife for any reason related to her "happiness" or "desires." The decedent made the evident choice that if someone was to suffer as the result of the conflicting interests of his wife and the remaindermen, it should not be his wife. This natural preference for his wife, though understandable, is nonetheless fatal to the estate tax deduction now sought by his estate.[4/] See Merchants Bank, supra; cf. Rand v. United States, 445 F. 2d 1166, 1170 (C.A. 2, 1971).

The Magistrate similarly erred in placing undue weight on the words of Article 3 "that my wife may occupy her own home and live in the manner to which she has been accustomed in our life together so long as she desires to do so." While, by itself, that does appear to be qualifying accustomed-standard-of-living

4/ No inference thus can be drawn that the unavailablity of the charitable deduction here is the result of faulty draftsmanship. Every settlor in such circumstances would be advised by counsel that unless narrow strictures are placed upon the wife's life interest, the charitable remainder deduction will be lost. With that knowledge, it would not seem unusual for a settlor, nonetheless, to provide broad invasion powers for his wife's happiness and carry out his charitable intentions without regard to the absence of a tax deduction.

language, in context, it is simply a further direction to the trustee to guard against its possible encroachment on his wife's life style. Being thus directory in nature, the language does not relate to, and in no way limits, the trustee's "absolute and unhampered discretion" to invade principal for the wife's "happiness" and "for whatever she may desire" which is in issue here.

It appears that the Magistrate's inquiry was to select one invasion standard which would control here and ignore all other language which was "ill-matched" to that standard. But apart from that approach being inconsistent with decedent's multi-faceted purposes, it is contrary to the approach taken by appellate courts which have faced nearly the same question in this context.

For example, in United States v. Commercial National Bank of Kansas City, 404 F. 2d 927, 931 (C.A. 10, 1968), the court disallowed an estate tax deduction for a charitable remainder where the trustee was empowed to invade corpus for the "comfort, welfare, contentment and happiness" of the life tenant. In addition, the trustee was admonished that the life tenant's "enjoyment of the benefits of the said trust estate should be considered as paramount." The trust instrument further stated (p. 931) that the purpose in providing for the "comfort, welfare, contentment and happiness" of the life tenant was to permit her to "continue to live in the manner in which she has been accustomed." But because the broader former standard was

inconsistent with the narrower standard-of-living language, the Tenth Circuit held that effect must be given to the former standard so as not to counter its clear mandate that the life tenant's interest should be paramount. The court reasoned (p. 934) that the only effect of the narrower "standard-of-living" language was "to create a definite, minimum standard of invasion in addition to the indefinite standard established by the rest of the paragraph." Moreover, in language highly pertinent here, the court stated (p. 934):

> It is clear that the whole of Paragraph 5, save for the phrase "and in order that she may continue to live in the manner in which she has been accustomed to live," indicates the intent to allow invasion of principal beyond the standard-of-living test. In 1954 when this trust was drafted, Merchants Bank had for 11 years been a landmark decision in this area of the law. To all lawyers practicing in the estate tax field, the Supreme Court's interpretation of "happiness" must have been abundantly clear. The consequences of an admonitory clause stating that the life beneficiary's enjoyment was to be "paramount" to the conserving of assets for the remainderman must also have been apparent.

The same result was reached in Union Trust Co. v. Tomlinson, 355 F. 2d 40 (C.A. 5, 1966) and State Street Bank and Trust Co. v. United States, 313 F. 2d 29 (C.A. 1, 1963), where, in each case, the settlor provided for the life tenant's accustomed standard of living but, in addition, authorized invasion of

corpus for other reasons.[5/] As the Court stated in State Street Bank (p. 31):

> * * * a gift of "support and maintenance," or an equivalent phrase, of itself is a gift to the widow of support in the manner to which she has been accustomed. It would seem fair to assume that the addition of "any other reasonable [need]" authorized the trustees to provide something more; to wit, a higher--and hence immeasurable--standard. * * *
>
> The problem here raised had long been conspicuous when this will was drawn. The area is a sensitive one. In a sense in every instance where invasion of principal is authorized, but the value of the remainder is claimed as a deduction, the testator has been attempting to eat his cake and have it, too. Yet it was clear that this testator could have provided for his widow's "comfortable support and maintenance," or, indeed, in terms for her "accustomed standard of living," and escaped this difficulty. Where he chose to say something more, with complete absence of specificity, we believe the risk of uncertainty should be his and not the government's.

Rather than reading Article 3 as providing such complementary, but different standards of invasion, the Magistrate sought to combine the divergent elements into a single accustomed standard of living standard. He reasoned (R. 27) that the accustomed standard of living enjoyed by decedent's wife required payment for "necessaries" plus "at least" $500 per month, and in support of that reasoning, he cites cases dealing with Connecticut law.

5/ To the same effect see Gammons v. Hassett, 121 F. 2d 229 (C.A. 1, 1941), cert. denied, 314 U.S. 673 (1941) and Marine Trust Co. of Western New York v. United States, 247 F. Supp. 278 (W.D. N.Y., 1965).

But, not only do the Connecticut cases not support his reasoning, they require a contrary conclusion. Connecticut law is best summarized in Hooker v. Goodwin, 91 Conn. 463, 467, 99 Atl. 1059, 1060 (1917) (relied upon by the Magistrate) where the court said "The term 'necessary,' in a connection such as this, is a variable one, and restricted or enlarged by the surrounding circumstances. Applied to Mrs. Hooker, it meant all reasonable necessaries suitable to her situation and station in life, having especial reference to the fact that she would be the widow of Mr. Hooker." At least in Connecticut, therefore, the "necessary expenses" of a widow are the equivalent of those expenses she would incur in maintaining her accustomed station in life. Any invasion standard providing for more than such "necessary expenses" brings in the element of uncertainty which is proscribed by the Regulations.

Finally, insofar as is relevant here, the Magistrate, in addressing and disposing of the question whether the word "happiness" introduces an element of uncertainty as to the trustee's power to invade corpus, concluded that while the word "happiness," standing alone, would prevent a charitable deduction in these circumstances, the following sentence of Article 3 somehow neutralizes or negates the ordinary meaning of the word. But as we stressed above, that following sentence introduces only a nondiscretionary minimum level of support when it speaks of permitting the wife to occupy her house and "live in the manner to which she has been accustomed." The

discretion given the trustee to invade corpus for the wife's happiness and the direction to pay at least $500 per month for her desires (above and beyond "her necessary expenses") create a wholly different standard of invasion, i.e., the trustee must, if necessary, invade for the former minimum purposes, and he may invade for the latter additional purposes.

It is unnecessary for us to argue that the presence of the word "happiness" in a granting clause such as this, ipso facto, disqualifies a charitable remainder deduction. Indeed, a settlor's words must always be read in context.[6/] But we know of no Section 2055 case which has permitted a charitable remainder deduction when corpus could be invaded for the life tenant's "happiness." The cases relied upon by the Magistrate for the proposition that the "happiness" standard was harmless here arose in a distinguishable legal context and, moreover, those cases are factually distinguishable as well.

United States v. Powell, 307 F. 2d 821 (C.A. 10, 1962) and Estate of Ford v. Commissioner, 53 T.C. 114 (1969), aff'd per curiam, 450 F. 2d 878 (C.A. 2, 1971) (cited by the Magistrate at R. 26) arose under Sections 2036 and 2038 of the Code (and their 1939 Code predecessors) which deal with transfers subject to reserved powers. If the grantor's reserved powers are sufficiently broad, those sections treat him as owner of the transfered property for federal estate tax purposes. (E.g., if

6/ See Salisbury v. United States, 377 F. 2d 700, 706 (C.A. 2, 1967).

A transfers four-percent Treasury bonds having a fair market value of $100,000 to B, and reserves the right to receive the interest payments for his life, the entire $100,000 ordinarily would be included in A's gross estate upon his death.) Those provisions apply to a variety of reserved powers, including the power, generally, to shift the enjoyment of the property from one beneficiary to another. In both Powell and Ford the question was whether the grantor's reserved lifetime power to invade corpus for the benefit of the income beneficiary in accordance with stated standards (including for his "happiness") was a sufficiently substantial power so as to warrant treating the grantor as owner of the property for estate tax purposes. Thus, while under Section 2055 the inquiry is whether a "happiness" standard causes the value of a charitable remainder interest to be sufficiently indefinite so as not to be "presently ascertainable" (and, hence, not deductible), the inquiry under Sections 2036 and 2038 is whether the power to invade for the income beneficiary's happiness gives the settlor such control over the property as to warrant treating him as owner thereof. Admittedly, the inquiry in each of the situations is superficially similar, but because Section 2055 is concerned with definite valuation and Sections 2036 and 2038 are concerned with retained control over the property, we submit that the apparent reluctance of courts in Section 2036 and 2038 cases to impose the well-established rigid test applicable under Section 2055 is due to the different purpose of the inquiry in those cases.

In Powell, supra, the Tenth Circuit found that not only did the word "happiness" stand alone, without corroborative expressions of liberality, it found that the granting clause as a whole expressed an intent that corpus be preserved, and that "happiness," therefore, should be construed narrowly. Moreover, that court's subsequent decision in Commercial National Bank, supra, a Section 2055 case much like this one, makes it clear that Powell simply does not apply here.

Similarly, the Tax Court in Ford found that the word "happiness" as used there warranted an unusually narrow construction. As the Tax Court stated (53 T.C., pp. 125-126): "Undoubtedly, the word 'happiness' standing alone, or in conjunction with language exhorting the trustee to administer the trust liberally for the benefit of one beneficiary over another, does not provide an ascertainable standard enforceable in a court of equity. Cf. Merchants Bank * * *. But that is not the case here."

Although this Court, without opinion, affirmed the Tax Court's decision in Ford, it appears noteworthy that in its later opinion in Hartford National Bank & Trust Co. v. United States, 467 F. 2d 782, 785-786 (1972), a Section 2055 case, it stated that "where the trustee is empowered to invade the trust corpus for the 'happiness' or contentment' of the income beneficiary, then the charitable remainder interest is perceived as not presently ascertainable." In a footnote to support that statement the Court purports to list the "happiness"

cases which hold to that effect. At the end of that footnote Powell is cited with the signal "But see," and the fact that the First Circuit questioned Powell is noted. But Ford, the only apparent "happiness" case previously decided by this Court, is not even mentioned.

There thus appears to be no basis in the Magistrate's opinion to support his clear departure from the controlling principles of law which require disallowance of the charitable remainder deduction in this case. The District Court, therefore, erred in adopting that opinion.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted,

SCOTT P. CRAMPTON,
Assistant Attorney General,

MEYER ROTHWACKS,
GARY R. ALLEN,
DONALD H. OLSON,
Attorneys,
Tax Division,
Department of Justice,
Washington, D. C. 20530.

Of Counsel:

STEWART JONES,
United States Attorney.

FEBRUARY, 1974.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 22d day of February, 1974, in an envelope, with postage prepaid, properly addressed to him as follows:

Louis Ciccarello, Esquire
Lovejoy, Cuneo & Curtis
168 East Avenue
~~South~~ Norwalk, Connecticut 06851

Meyer Rothwacks/mk
MEYER ROTHWACKS,
Attorney.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

(a) In General.--For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers * * *

* * *

(2) to or for the use of any * * * [qualifying organization] * * *

* * *

For purposes of this subsection, the complete termination before the date prescribed for the filing of the estate tax return of a power to consume, invade, or appropriate property for the benefit of an individual before such power has been exercised by reason of the death of such individual or for any other reason shall be considered and deemed to be an irrevocable disclaimer with the same full force and effect as though he had filed such irrevocable disclaimer.

* * *

Treasury Regulations on Estate Tax (1954 Code) (26 C.F.R.):

§ 20.2055-2 Transfers not exclusively for charitable purposes.

(a) Remainders and similar interests. If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor

from column 4 of Table I or Table II of § 20.2031-7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of § 20-2031-7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments, may be submitted by the executor to the Commissioner who may, if conditions permit, supply the factor requested. If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 20.2031-7.

(b) Transfers subject to a condition or a power. If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust by the decedent consist of stock in a corporation the fiscal policies of which are controlled by the decedent and his family, that the trustees and remaindermen are likewise members of the decedent's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees are not members of the decedent's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite

enjoyment of income to the charitable organization, no deduction will be allowed.

* * *

GPO 862-503 PO T12